ECB charts path for new stimulus

July 25 2019, by Jean-Philippe Lacour

ECB chief Mario Draghi has opened the door for new stimulus measures

The European Central Bank signaled Thursday it could unleash a new stimulus package and slash rates further, in a bid to shore up stubbornly low inflation and kickstart sluggish growth in the eurozone.

The change in monetary policy direction came as clouds darken outside the bloc, with growing fears over US-led protectionism, weakness in emerging markets and geopolitical risks, dampening the economic mood.

Trouble was also looming across the English Channel, as the appointment of Boris Johnson as Britain's new Prime Minister heightened the danger of a no-deal Brexit.

Johnson's threat to withhold from the EU the £39 billion ($49 billion) divorce bill in case of a hard Brexit could spell further turmoil for the bloc.

For ECB chief Mario Draghi, these persistent uncertainties were hurting economic sentiment, particularly in the manufacturing sector.

"This outlook is getting worse and worse in manufacturing, and it's getting worse and worse in countries where manufacturing is very important, and because of value chains, this propagates all over the eurozone," he told journalists.

Against this backdrop, the ECB's target of nudging inflation back up to around 2.0 percent was looking increasingly out of reach.

"We don't like what we're seeing" in terms of inflation trends, Draghi said.

"That's very important," he said, as he explained why the central bankers were now ready to open their war chest again.

'September big bang'

The ECB's governing council left the rate on the bank's main refinancing operations at zero, on its marginal lending facility at 0.25 percent and on its deposit facility at -0.4 percent.

But crucially, it hinted rates could fall still further—saying they would be kept at "their present or lower levels at least through the first half of

2020".

In addition, the ECB said officials had been tasked to look at other options, including "new net asset purchases".

ING analyst Carsten Brzeski said the ECB was "preparing the big September bang".

"It now increasingly looks as if the September meeting will not only bring a single measure but rather a package of several measures," the expert said.

'Rapidly deteriorating outlook'

Expectations for a possible move have been heightened in recent weeks by the ECB itself talking up the possibility of action.

As he had already done in June, Draghi said the ECB would not wait for economic conditions to worsen before acting.

While plans for further interest rate cuts had been widely expected, markets had not anticipated such a swift return of the massive bond purchase scheme which the ECB only put to an end in December.

"The fact that the ECB is reacting so strongly is due to the rapidly deteriorating economic outlook for the eurozone," said LBBW analyst Jens-Oliver Niklasch.

Surveys have for months pointed to an economic slowdown in the second and third quarters from the 0.4 percent growth booked in January-March.

Draghi noted that last growth projections had suggested a rebound in the second half of the year, but "now incoming signs show weakness of growth in the third quarter as well—so this rebound becomes less likely now".

Slower growth in turn threatens the central bank's target for area-wide inflation, which came in at 1.3 percent in June.

Negative rates are designed to prod the financial system into lending and investing cash in the real economy, rather than parking it safely with the central bank or in government debt.

Commercial banks have grumbled at the burden of negative rates, saying it undermines their business model.

But Draghi sought to placate them.

"If we are to lower interest rates, that will come with mitigating measures," he said.

These could include a "tiering" system to exempt some deposits from the harshest negative rate, as central banks in Sweden, Switzerland, Denmark and Japan have introduced.

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